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TO RUEHC/SECSTATE WASHDC IMMEDIATE 1266
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RUEATRS/DEPT OF TREASURY WASHDC IMMEDIATE

UNCLAS MANILA 001656

SENSITIVE

SIPDIS

STATE FOR EB/IFD/OIA, EB/ESC AND EAP/PMBS
STATE PASS USAID FOR AA/ANE, AA/G
STATE PASS EXIM, OPIC AND USTR
USAID FOR AA/ANE AND AA/EGAT
DOE FOR TOM CUTLER
TREASURY FOR LMOGHTADER
TREASURY ALSO FOR OASIA
USDOC FOR 4430 ITA/MAC/ASIA & PAC/KOREA & SE ASIA/ASEAN

E.O. 12958: N/A

TAGS: [ENRG](#) [EFIN](#) [EXIM](#) [RP](#)

SUBJECT: AES' PHILIPPINE INVESTMENT: BUYER'S REMORSE?

REF: MANILA 01417

SENSITIVE BUT UNCLASSIFIED

11. (SBU) Summary: Officials of U.S. energy giant AES alleged in a meeting with Embassy officers on July 1 that the Philippine state-owned National Power Corporation was abusing its market power, and the Energy Regulatory Commission was violating its own guidelines in order to lower the wholesale price of electricity. AES became the largest U.S. investor in the Philippine energy sector in April 2008 when it finalized the purchase of a 660-megawatt coal-fired plant in Masinloc, Zambales Province for \$930 million. The company now finds that artificially depressed electricity rates and increasing fuel costs have eliminated profit margins. AES warned of a chilling effect on energy-sector investments that will create eventual electricity shortages. End summary.

12. (SBU) The AES executives said they had been induced to purchase the Masinloc power plant by government assurances that power-generating assets were being privatized and that the Energy Regulatory Commission would follow and enforce rules that tie prices to the cost of supplies. According to AES executives, the government now subsidizes the government-owned power corporation and brings rates down to a level below even the variable costs of power generation, making it impossible for AES and other independent power producers to recover their fixed costs and make debt repayments. The executives informed Embassy officers of the difficulties their company faced and solicited practical approaches for dealing with the sensitive financial and political ramifications of this problem.

13. (SBU) The AES executives pointed out that coal prices had increased from \$67 per metric ton in July 2007, the month of their successful bid, to \$170 per metric ton in July 2008. Government regulations state that the recovery period (i.e., the lag in adjusting wholesale prices to reflect changes in the cost of inputs) for utilities shall not exceed six months, but in practice, there were much longer delays. The AES executives claimed that the extended recovery period amounted to a huge subsidy for the cost of electricity, and noted that the National Power Corporation has not filed for increased cost recovery since July 2006, which artificially depresses prices.

14. (SBU) The AES executives said like most of the existing power producers, they strongly support retail competition and open access, as espoused by the Electric Power Industry Reform Act, but the cost of electricity must reflect the true price and allow for better

price signals to influence electricity consumption. Only then, they maintained, would private power generators be able to compete on a level playing field, paving the way for open access. ("Open access" would allow consumers drawing more than one megawatt of energy to contract directly with power generation companies. The legal trigger to allow open access is privatization of 70% of National Power Corporation generation assets. Currently, about 48% of National Power Corporation assets have been privatized through the Power Sector Assets and Liabilities Management Corporation or PSALM.)

15. (SBU) The AES executives warned that the current situation would strongly discourage any additional investment in power generation and that the stage was being set for serious power shortages within the next three to five years, a situation similar to the crisis that gripped the country back in the 1990s.

16. (SBU) Comment: AES paid \$930 million for this coal-fired plant, a record sale price for any Philippine government-owned asset. With the current electricity market dynamics it is hard to imagine that AES will recover its investment any time soon.

Kenney